

PRIMARY AND SECONDARY OBLIGATIONS.

Needless confusion has resulted with reference to original and collateral promises made by a surety, guarantor, indemnitor and indorser, because "there is considerable loose writing in the text books."¹ An understandable nomenclature will aid in the dissipation of that confusion. These terms present certain similarities, "but there is a marked distinction, both in the form and effect of the undertakings."² The purpose of this discussion is threefold: First, an elementary one, to define the meaning of these various terms employed by the courts; second, to consider the operative facts necessary to bring a case within those definitions; third, the consideration of the result when a specific case comes within the one or the other of these classes.

Personal contracts guaranteeing the payment of the obligation of another are of ancient origin. We are told that "the contract of suretyship is coeval with the first contracts recorded in history."³ Roman law will shed much light on modern problems of suretyship and guaranty.⁴

Contractual relations may be classified as independent and accessorial, since in the former the promisor incurs the primary liability and has no recourse against anyone in case the promisee compels him to pay. Those liable on accessorial obligations, on the other hand, have, in most cases, a right to compel some one else to reimburse them for the loss sustained, because an accessorial liability is subordinate to a principal liability, which the law implies the principal obligor promised to pay. In the sense used in the cases, the accessorial obligation may be primary or

¹ *McMillan et als. v. Bull's Head Bank*, 32 Ind. 11, 13, 2 Am. Rep. 323 (1869).

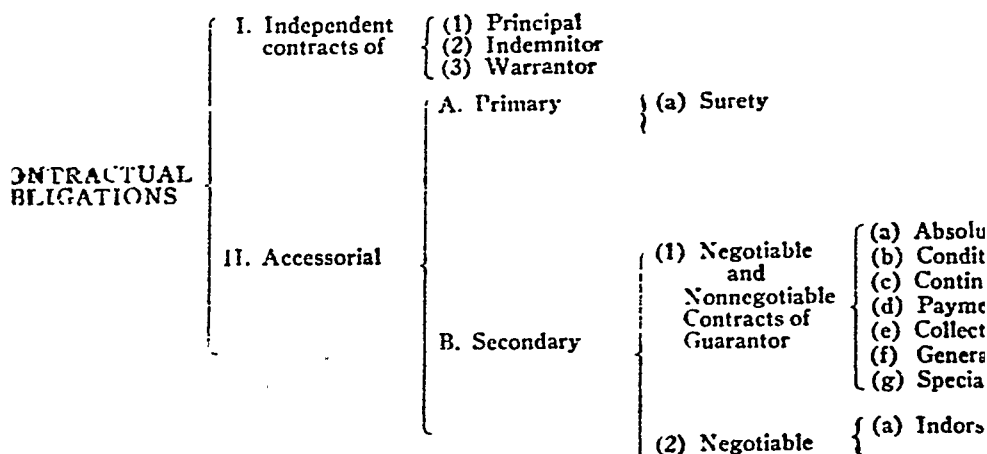
² *Judge Dedy in Hall v. Weaver*, 34 Fed. 104, 106, 13 Sawy. 188 (1888).

³ 2 Story on Contracts, 5th ed. (1874), p. 319, n. 1. In Biblical writings the subject is alluded to as if it were then well understood. About 1000 B. C., Solomon said: "He that is surety for a stranger shall smart for it; and he that hateth suretyship is sure." Proverbs 11:15. "A man void of understanding striketh hands, and becometh surety in the presence of his friend." Proverbs 17:18. See also Proverbs 22:26. An excellent historical discussion, containing reference to original sources, is found in an article on *The Surety*, by Professor Wm. H. Lloyd, 66 U. of Pa. L. Rev., 40 (1918).

⁴ BUCKLAND, TEXT BOOK OF ROMAN LAW (1921), 441 seq.; GAIUS III. 110-127; INSTITUTES, III, 20.

secondary, the difference being that the primary contract is entered into at the same time, on the same contract, with another person, while in the latter there are two contracts relating to the same transaction.⁵

The following outline is believed to contain the various kinds of obligations arising out of the contractual relationship:



To an independent contract, but two parties are required. To an accessorial contract, at least three parties are necessary: (a) the principal, for whose benefit it was made; (b) the obligee-creditor to whom it was made; (c) the obligor-surety-guarantor, who undertakes that the principal's obligation will be performed.

No controversy need arise over the obligation of the principal, as the courts recognize he is "the one for whose account the contract is made, whose debt or default is the subject of the

⁵ Fields v. Willis, 123 Ga. 272, 51 S. E. 280, 282 (1905), says: "While the liability of both (surety and guarantor) is accessorial to the principal, in the case of a surety the obligation is primary, and the guarantor's liability is secondary."

Hooper v. Hooper, 81 Md. 155, 31 Atl. 508 (1895): "Both are accessory contracts; that of a surety is in some sense conditional; that of a guarantor is strictly so. A guaranty is secondary, whilst suretyship is a primary obligation."

The classification in the Roman law was similar. "The creditor asks: *centam quæ Titius mihi debet, eadem fide tua esse jubes?* The surety replies: *fide me esse jubeo*. The effect of such a *fidejussio* is to make the surety correal debtor with the principal debtor, his correal liability being accessory to that of the principal, i. e., he (the surety) is liable *after* the principal debtor." SOHM'S INSTITUTES OF THE ROMAN LAW (Ledlie's Tr. 1901, 2d Ed.), 404.

transaction."⁶ He can demand reimbursement from no one. The entire loss must eventually fall upon him. His agreement, while contemporaneous with that of the surety, is reliant upon no other agreement, obligation or person.

"Indemnity contracts are of great variety."⁷ But the indemnitor may be said to be the one who, by contract, agrees to secure another against an anticipated loss or damage.

"A contract of indemnity is an original and independent one. Between the promisor and the promisee, there is a direct privilege, while there is no debt owed by the third person to the promisee, and there is no remedy against such third person."⁸

The liability of the warrantor must be an independent one. As usually understood, he undertakes absolutely against the defect in quantity, quality, or title, or that the quantity or quality shall be of an agreed standard. True, his contract usually relates to another contract but his promise is independent of that of any other person. Without an express agreement, he cannot compel reimbursement from any one, and it is absolute.⁹

⁶ STEARNS ON SURETYSHIP, Section 5, 3d Ed. (1922), BRANDT ON SURETYSHIP AND GUARANTY, Sec. 4, 3d Ed. (1905).

⁷ *Wolthausen v. Trimpert*, 93 Conn. 260, 105 Atl. 687, 688 (1919).

⁸ *Hall et al. v. Equitable Surety Co.*, 126 Ark. 535, 191 S. W. 32, 34 (1917).

⁹ The opinion in the case of *Pacific Power and Light Co. v. White*, 96 Wash. 18, 164 Pac. 602 (1917), said in part:

"We think it plain, however, that the contract here involved is one of warranty and not of guaranty. While these words are often somewhat indiscriminately used, they do not carry the same meaning or refer to obligations of the same legal nature. In 12 R. C. L. 1056, the difference in legal effect between a 'warranty' and a 'guaranty' is stated as follows:

"It seems that derivitively the words 'warranty' and 'guaranty' import the same kind of transaction, and they are still loosely employed as though they were synonymous. In legal conception, however, a guaranty is distinguishable from a warranty. Each is an undertaking by one party to another to indemnify or make good the party assured against some possible default or defect in the contemplation of the parties; but a guaranty is understood, in its strict and legal and commercial sense, as a collateral warranty, and often as a conditional one, against some default or event in the future, whereas the term 'warranty' is generally understood as an absolute undertaking in *præsenti* as well as in *futuro*, against the defect, or for the quantity or quality contemplated by the parties in the subject-matter of the contract. In the sale of a commodity an undertaking by the seller to answer for the defects therein is construed as a warranty, though the seller uses the term 'guaranty.'" See *Gay Oil Co. v. Roach*, 93 Ark. 454, 125 S. W. 122 (1910).

Accessorial obligors are liable upon an agreement entered into in reliance upon another contract which is necessary to give the accessorial contract vitality.

Casual reading of the opinions will convince that courts have frequently used the term warrantor or indemnitor or guarantor or surety when it was inapplicable.¹⁰

These obligations can be understood best by considering certain operative facts necessary to exist in order to bring a case within them. A comparison of the nature of some of the obligations will help to clarify.

There should be no confusion between an indemnitor and a surety. A surety may become liable on an instrument which is either negotiable or non-negotiable. He binds himself for the payment of money or the performance of an act, for another person, who is also bound for the same. As defined in judicial language:

"A surety . . . is a person who, being liable to pay a debt or perform an obligation, is entitled, if it is enforced against him, to be indemnified by some other person, who ought himself to have made payment or performed the obligation before the surety was required to do so."¹¹

DeColyar in his book on Guarantee and Surety (1887), p. 2, says: "It seems that originally the words warranty and guaranty were the same; the letter *g* of the Norman-French being convertible with the *w* of the German and English, as in the names William or Guillaume. They are sometimes used indiscriminately; but, in general, warranty is applied to a contract as to the title, quality or quantity of the thing sold . . . ; and guaranty is held to be the contract by which one person is bound to another for the due fulfillment of a promise or engagement of a third party." See *Sturges & Co. v. Bank of Circleville*, 11 Oh. St. 153, 168-169 (1860).

"Referring to guaranty and warranty: 'The two are often used interchangeably and with the same effect.' *Gay Oil Co. v. Roach*, 93 Ark. 454, 125 S. W. 122 (1910).

In *Thomas v. Cook*, 8 Barn. & Cress. 728 (1828), Bayley, J., unnecessarily to the decision of the facts before the Court, said: "A promise to indemnify does not, as it appears to me, fall within either the words or policy of the Statute of Frauds; . . ." To which Lord Denman, in *Green v. Cresswell*, 10 Adol. & Ellis, 453 (1839), countered: "For every promise to become answerable for the debt or default of another may be shaped as an indemnity; . . ." That the legal consequences depend upon the facts of the particular case and not on whether the parties have used the term indemnity or guaranty, see *Cripps v. Hartnoll*, 4 B. & S. 414 (1863).

¹¹*Reissaus v. Whites et al.*, 128 Mo. App. 135, 106 S. W. 603, 604-605 (1907).

The surety becomes liable contemporaneously with the principal, undertaking to pay his obligation, and the consideration which binds the principal is sufficient to bind the surety. If the surety is compelled to pay, he has the right, without any express agreement, to bring an action against the principal to reimburse himself.¹² But the indemnitor becomes bound on an independent non-negotiable contract. Independent consideration is required to support it. Without an express agreement, the indemnitor cannot recover against the person for whose benefit he made the contract.¹³ It will be seen that the surety's contract is dependent on that of the principal, from whom he may finally recover reimbursement, while the indemnitor's agreement is an independent one, his liability being without recourse against any one.

The distinctions between a contract of indemnity and one of guaranty are several. (a) The promisee in an indemnity contract does not owe a debt to a third person. The indemnitor's contract is an original one, to save the indemnitee harmless against some future loss or damage. It is well recognized that the guarantor's contract is accessory and secondary to some other obligation which is the principal or primary one.¹⁴ (b) Whenever the indemnitee suffers loss, the indemnitor's liability begins, while the guarantor's liability begins when the principal debtor defaults, subject to the condition in certain cases that notice must be given the guarantor of the default of the principal.¹⁵ (c) If the liability of the third person is pre-existing,

¹² STEARNS ON SURETYSHIP, Sec. 6; Sec. 229, 3d Ed. (1922).

¹³ "The contract of the indemnitor is an original undertaking. The indemnitor is liable only to the indemnitee, and his assigns, and, unless he has stipulated for it, he has no remedy over against the party for whose benefit the contract was made." BRANDT, Sec. 5, 3d Ed. (1905). But the indemnitor is entitled to be subrogated to the rights of the indemnitee against the person for whose default the former became liable. *Reid v. Pauly*, 121 Fed. 652 (1903). See also, BRANDT, Sec. 348, 3d Ed. (1905).

¹⁴ *Hall v. Equitable Surety Co.*, 126 Ark. 535, 191 S. W. 32 (1917); *U. S. Fidelity & Guaranty Co. v. Bank of Hattiesburg*, 128 Miss. 605, 91 So. 344 (1922); *Western Surety Co. v. Kelley*, 27 S. Dak. 465, 131 N. W. 808 (1911); *Texas Fidelity & Bonding Co. v. General Bonding & Casualty Co.*, Tex. Civ. App., 184 S. W. 238 (1916).

¹⁵ See the distinctions mentioned in the opinions of Lopes, *L. J.*, and Davey, *L. J.*, in *Guild v. Conrad*, 2 Q. B. 885, 895-896 (1894). The opinion of Lopes, *L. J.*, is discussed in *Beattie v. Dinnick*, 27 Ont. Rep. 285, 292 (1896). See also 22 WASH. L. REP., 479.

and not merely in contemplation when the defendant makes his promise, it is always a guaranty. It is never, under such conditions, a contract of indemnity.¹⁸ The guarantor, when he pays the obligation, can recover reimbursement against the principal; while the indemnitor has no right against any one.¹⁷

More frequently the courts confuse the terms surety and guarantor; but their undertakings are very different. And it is frequently of great practical importance to be able to distinguish the two where the statute attempts to alter the common law rules as to either one.¹⁸ The courts recognize surety to be a more general term than guarantor; and in a statute employing the word "surety" it will generally include guaranty, where there is nothing in the context to limit its application.¹⁹ The points of similarity are first, that both a surety and guarantor may be liable on an instrument either negotiable or non-negotiable; second, they are liable for the debt or default of another person. Dissimilarities in many respects have been noted, some of which have been criticized: (a) The rules of the common law have been said to apply to sureties, while those of the law merchant, so far as negotiable instruments are concerned, control the interpretation of the guarantor's obligation.²⁰ (b) The surety undertakes to pay his principal's obligation absolutely; the guarantor's undertaking is to pay if the principal *cannot*.²¹ The former promises

¹⁸ See *Beattie v. Dinnick*, 27 Ont. Rep. 285, 293 (1896); FALCONBRIDGE ON "GUARANTEES AND THE STATUTE OF FRAUDS" (1920) 40 CAN. L. T. 388, 397, 68 U. OF PA. L. REV., 137, 155.

¹⁹ BRANDT, Sec. 226; 5, 3d Ed. (1905); ARNOLD ON INDEMNITY CONTRACTS AND THE STATUTE OF FRAUDS, MINNESOTA LAW REVIEW, April, 1925, p. 401, 414-416.

²⁰ *Chafoin v. Rich et al.*, 77 Cal. 476, 19 Pac. 882 (1888); 9 MINN. L. REV., 401, 414-416 (Ap., 1925).

²¹ *Gagan v. Stevens*, 4 Utah 348, 9 Pac. 706, 707 (1886).

²² "The rules, however, of the common law as to sureties, are not strictly applied to guarantors, but rather the rules of the law merchant; *Courtis v. Dennis*, 7 Met. (Mass.) 510 (1844); BRANDT, Sec. 2, 3d Ed. (1905). But the Ohio Supreme Court, in *Castle v. Rickly*, 44 Oh. St. 490, 496 (1886), said, comparing guarantors and indorsers: "By such guaranty, the guarantor is not made a party to the note, and his contract, unlike that of an indorser, is governed by the rules of the common law, and not those peculiar to the law merchant."

²³ *Stein v. Whitman*, 156 App. Div. 861, 142 N. Y. S. 4 (1913). Many authorities make this distinction. While it is euphonious, some authorities say it will not bear analysis. The guarantor is frequently held liable, as hereinafter

that the debt will be paid, while the latter guarantees the solvency of the principal. In effect the surety says to the obligee: "If the principal does not pay, I will pay." The guarantor says to the obligee: "Proceed first against the principal, and, if he should not be able to pay, then you may proceed against me."²² The criteria by which it may be determined whether one is a surety or a guarantor was thus expressed in a recent opinion:

"The general test of whether a person is a surety or a guarantor is determined by the test as to whether the person undertaking to pay binds himself to do so at all events, or absolutely, or whether he merely undertakes to bind himself for the payment, provided it cannot be made out of the principal."²³

(c) The surety joins with the principal in his contract, and is an original party with him. The guarantor becomes liable on an agreement independent of the one on which the principal is bound.²⁴ One who contracts jointly with the principal cannot be a guarantor.²⁵ (d) The surety's agreement is supported by

explained, where he makes an absolute guaranty. See STEARNS ON SURETYSHIP, p. 6, note 9, 3d Ed. (1922). If the statement be interpreted to mean that the conditional guarantor promises to pay if the obligee, after diligence and a suit against the principal is unable to recover, or to satisfy the debt, it is a proper distinction.

²² *Manry v. Waxelbaum Co.*, 108 Ga. 14, 33 S. E. 701 (1899); *McIntosh Huntington Co. v. Reed*, 89 Fed. 464, 466 (1898); *Fields v. Willis*, 123 Ga. 272, 51 S. E. 280 (1905). ROWLATT ON PRINCIPAL AND SURETY, 2 (1899), says: "The liability of a surety is often spoken of as a liability to pay 'if the principal does not.' This does not mean that his liability is necessarily only conditionally enforceable, but merely that it is collateral. Being collateral the liability of a surety is in substance from the surety's point of view certainly contingent, because if the principal pays the debt is satisfied and the surety is free. And what is contemplated is that the principal will pay. But this may be so, although the undertaking of the surety is as absolute as that of the principal."

²³ *Bishop v. Currie-McGraw Co.*, Miss., 97 So. 886, 889 (1923).

²⁴ STEARNS ON SURETYSHIP, Sec. 6, 3d Ed. (1922): "In other words, a guaranty is a contract in and of itself; but it also has relation to some other contract, or some obligation with reference to which it is collateral, and it always requires a consideration." *Briggs v. Latham*, 36 Kan. 205, 13 Pac. 120, 131 (1887). See *Bedford v. Kelley*, 173 Mich. 492, 139 N. W. 250 (1913).

²⁵ In *McMillan et al. v. The Bull's Head Bank*, 32 Ind. 11 (1869), *Frazier. C. J.*, said: "There is no case in the books to our knowledge, and some pains has been bestowed in their examination, in which one contracting jointly with the principal debtor has been deemed a guarantor and allowed to avail himself of such defenses as are peculiar to that character." Approved in *Bryant v. Stout*, 16 Ind. App. 380, 44 N. E. 68 (1896).

the consideration on which that of the principal is founded, and no other need be proved.²⁶ The contract of the guarantor must be founded on new and independent consideration, except in three cases: first, where the guarantor requested the loan or credit to the principal, and his written guaranty is made after the principal's contract is made; second, where the obligation of the principal debtor is founded upon consideration, and at, or prior to that time, the verbal promise of the guarantor is made, and enters into the inducement for giving credit, then the original consideration of the principal will support the subsequent written promise of the guarantor; third, where the guarantor's contract is made at the same time as that of the principal, and was the basis of the credit extended to him. In form it is a guaranty, but in reality it is that of suretyship.²⁷ But even if the consideration of the guarantor is founded upon the same consideration that supports the principal's obligation, within one of the three exceptions just noted, and he is substantially a surety, the principal and guarantor cannot be sued jointly, because the guarantor's liability is separate from and independent of that of the

²⁶ *Kissire v. Plunkett-Jarrell Grocer Co.*, 103 Ark. 473, 145 S. W. 567 (1912); *Bassett v. O'Neil Coal and Coke Co.*, 140 Ky. 346, 131 S. W. 25 (1910).

²⁷ *Williams v. Perkins*, 21 Ark. 18 (1860); *Kissire v. Plunkett-Jarrell Grocer Co.*, 103 Ark. 473, 145 S. W. 567 (1912); *Paul v. Stackhouse*, 38 Pa. St. 302 (1861).

In the opinion in *Read v. Cutts*, 7 Greenleaf (Me.) 186 (1831), it was stated: "Another distinction between a surety and a guarantor is that a promise of a surety is supported by the consideration on which the promise of the principal is founded, and no other need be proved; but the engagement of a guarantor must be founded on some new or independent consideration, except in those cases where the guaranty is given at the time the debt is contracted by the principal, and so may be considered as connected with it." See *Briggs v. Latham*, 36 Kan. 205, 13 Pac. 129, 131 (1887).

In *International Harvester Co. of America v. Fleming*, 109 Me. 104, 82 Atl. 843, 844 (1912), this was the view of the Court: "Where the guaranty is collateral to the principal contract, but is made at the same time and becomes an essential ground of the credit given to the principal or direct debtor, there is not, or need not be, any other consideration than that moving between the creditor and the original debtor under the principal contract."

The Roman law made a similar distinction between suretyship and guaranty. In 2 Colquhoun's *Summary of the Roman Civil Law*, Sec. 1602, it is said: "Suretyship may form an ingredient in all contracts, and it often happens, that the real credit is given rather to the surety than to the principal obligee."

"Guarantees are another species of suretyship, and their only essential is, that a sufficient cause or consideration should appear on the face of them."

principal.²⁸ (e) The liability of the surety is primary and direct; it begins with the agreement. The liability of the guarantor is collateral and secondary; it does not begin until the principal defaults.²⁹ (f) The surety may be sued jointly with the principal; but in the absence of statutory permission, a guarantor cannot be sued jointly with his principal, though several guarantors whose obligations were simultaneously made, may be sued jointly.³⁰

The above distinctions were classically set forth by Mr. Justice McClellan, to whose language reference has been made so frequently by courts and text writers, that it is appropriate to quote from the opinion in which he announced them:

"The distinction between the two classes (surety and guarantor) of undertakings is often shadowy, and often not observed by judges and text writers; but that there is a substantive distinction, involving not infrequently important consequences, is, of course, not to be doubted. It seems to lie in this: that when the sponsors for another assume a primary and direct liability, whether conditional or not, in the sense of being immediate or postponed till some subsequent occurrence, to the creditor, they are sureties; but

²⁸ "Where the guaranty is made at the same time with the principal contract, and becomes an essential ground of credit, there is no doubt the consideration extends to the contract of guaranty. But a contract of guaranty is not a primary obligation to pay, but is an undertaking that the debtor will pay. The contract of the maker and sureties upon a promissory note is to pay the same. The guarantor is not a promisor with the maker. How, then, can he be sued with the maker of a promissory note upon an obligation to which he is not a party? The contract of guaranty is a separate and independent contract and the liability of the guarantor is governed by the express terms of the contract. He cannot be joined in an action against the maker of a note, he not being liable as maker." *Mowery v. Mast et al.*, 9 Neb. 445, 4 N. W. 69, 71 (1889).

²⁹ "The contract of the guarantor is collateral and secondary. It differs in that respect generally from the contract of a surety which is direct; and in general the guarantor contracts to pay if, by the use of due diligence, the debt cannot be made out of the principal debtor, while the surety undertakes directly for the payment, and so is responsible at once if the principal debtor makes default." *Kearns v. Montgomery*, 4 West Va. 29 (1870).

It is believed the following statement found in *DeCOLYAR, GUARANTEES AND SURETY*, 207 (1897), is erroneous: "The liability of the former (the surety) is, therefore termed *secondary*, whilst that of the latter (the principal debtor) is termed *primary*." Both principal and surety are primary debtors. *Union Trust Co. v. McGinty*, 212 Mass. 205, 98 N. E. 679 (1912). *Story on Contracts*, Sec. 1111, 5th Ed. (1874), states emphatically that "suretyship is a *primary* obligation."

³⁰ *Clark v. Morgan*, 13 Ill. App. 597, 598 (1883); *Read v. Cutts*, 7 Greenleaf (Me.) 186 (1831).

when this responsibility is secondary, and collateral to that of the principal, they are guarantors. Or, as otherwise stated, if they undertake to pay money or do any other act in the event their principal fails therein, they are sureties; but, if they assume the performance only in the event the principal is unable to perform, they are guarantors. Or, yet another and more concise statement, a surety is one who undertakes to pay if the debtor do not; a guarantor, if the debtor cannot. The first is sponsor absolutely and directly for the principal's acts; the latter, only for the principal's ability to do the act. 'The one is the insurer of the debt; the other, an insurer of the solvency of the debtor.' This is the essential distinction. There is another, going as well to its form. The contract of suretyship is the joint and several contract of the principal and surety. 'The contract of the guarantor is his own separate undertaking, in which the principal does not join.' Indeed, it has been held, pretermittting all other considerations, that no contract joined in by the debtor and another can be one of guaranty on the part of the latter (*McMillan v. Bank*, 32 Ind. 11) though we apprehend that a case might be put, involving only secondary liability on the sponsors, though the undertaking be signed also by the principal. However that may be, it is certain that in most cases the joint execution of a contract by the principal and another operates to exclude the idea of a guaranty, and that in all cases such fact is an index pointing to suretyship."³¹

The terms guarantor and indorser are not so susceptible of confusion. Both are secondarily liable; but their contracts are

³¹ *Saint v. Wheeler and Wilson Mfg. Co.*, 95 Ala. 362, 10 So. 539 (1892). *Accord*, *Rawleigh Medical Co. v. Tarpley*, 5 Ala. App. 412, 59 So. 512 (1912); *News-Times Publishing Co. v. Doolittle*, 51 Colo. 386, 118 Pac. 974 (1911); *Cone v. Eldridge et al.*, 51 Colo. 564, 119 Pac. 616 (1911); *Musgrove v. Luther Publishing Co.*, 5 Ga. App. 279, 63 S. E. 52 (1908); *Rouss v. King*, 69 S. C. 168, 48 S. E. 220 (1904). *OGDEN ON NEGOTIABLE INSTRUMENTS*, Sec. 220 (1909).

See *Lloyd, The Surety*, 66 U. OF PA. L. REV., 40, 55-57, to the effect that in modern English law the term "guarantee" has practically supplanted 'suretyship' as the generic term for contracts of an accessory nature," and that "even in America there is no magic in the use of one word or the other, the liability depending on the terms of the contract."

Although *DeColyar* entitles his book "A Treatise on the Law of Guarantees and of Principal and Surety," therein suggesting a difference, nevertheless on the first page of his book he treats them as synonymous terms. But in the note on the first page he says that "in America, there is a distinction between a surety and a guarantor."

materially different. The guarantor may be liable on an instrument which is either negotiable or non-negotiable. The indorser's liability is only upon a negotiable instrument.³² The indorsement must be written on the instrument itself or on a paper attached to it.³³ As between the indorser and indorsee, the former's contract, like that of a guarantor, is a new and independent one.³⁴ One who makes a blank indorsement of a negotiable instrument, and without any restriction enters into two contracts: (a) one, which is executed, is the sale or assignment of the instrument; (b) the other, which is executory and conditional, is to pay the indorsee the amount called for in the instrument if the latter fails to collect from the person primarily liable and gives proper notice of dishonor to the indorser.³⁵ Reserving for subsequent discussion the difference in effect between the liability of the guarantor and indorser, it will be sufficient for the present to observe that:

"The contract of both is conditional, but the conditions are unlike. The contract of indorsement is primarily that of transfer; the contract of guaranty is that of security."³⁶

³² See *Orrick v. Colston*, 7 Gratt. (Va.) 189, 195 (1850).

³³ N. I. L., Sec. 31. If the indorsement is on a separate paper, not attached to the note, it is an assignment, and does not cut off the defenses available to the maker. *Fassler v. Streit et al.*, 92 Neb. 786, 139 N. W. 628 (1913).

³⁴ *Hodges v. Steward*, 1 Salk. 125 (1691): for the indorsement is in nature of a new bill."

³⁵ *Maine Trust and Banking Co. v. Butler*, 45 Minn. 506, 48 N. W. 333 (1891); *Mangold and Glandt Bank v. Utterback*, 54 Okla. 655, 160 Pac. 713, 715 (1916).

In *Rockfield et al. v. First National Bank of Springfield*, 77 Oh. St. 311, 83 N. E. 392 (1907), it was said that: "Every indorser who indorses without qualification guarantees to all subsequent holders the genuineness of the instrument, the title, the capacity of previous parties to the contract, etc., and engages that, on due presentment, the instrument shall be accepted or paid or both, as the case may be, and that if it be dishonored, and the necessary proceedings on dishonor be duly taken, he will pay the amount thereof to the holder or to any subsequent indorser who may be compelled to pay it."

³⁶ *Brady v. Reynolds*, 13 Cal. 31, 32 (1859); *Wolf v. American Trust and Savings Bank*, 214 Fed. 761, 132 C. C. A. 410 (1914). Mr. Justice Strong, in the leading case of *Brown v. Curtis*, 2 Com. (N. Y.) 225 (1849), in the beginning of his opinion for the court, noted first, the similarity of the engagements of an indorser and a guarantor, and second, differentiated their liabilities. He said: "The direct engagement of the indorser of a negotiable note, and of the guarantor of the payment of a note, whether negotiable or not, is the same. Both undertake that the maker will pay the amount when it shall become due. If there is a failure in such payment, both contracts are broken. Ordinarily, upon the breach of a contract, the party bound for its performance immediately

To transfer by indorsement a negotiable instrument payable to order, the payee must indorse. The United States Supreme Court decided that a written guarantee by the payee on the back of the instrument, complete in itself, does not transfer his interest in it, because the guarantor does not transfer title and a guarantor is not an indorser. His guaranty implies an intent to destroy the negotiable character of the instrument. Consequently the transferee takes it subject to the equities of the maker. It is an assignment, subject to the prior equities, and not an indorsement.³⁷ But a line of cases, numerically preponderating, it is said oppose this view, for the reason that "the addition of words which either limit or enlarge the usual liability on his part, which would arise from a blank indorsement does not destroy the fact that the entry is an indorsement upon a negotiable paper, or prevent its efficacy as a method of passing the legal title upon negotiation."³⁸ Such cases indicate that the guaranty written on the back of a negotiable instrument might be both a guaranty for security and a transfer of title.³⁹ Of course, the logic of this

becomes liable for the consequent damages. *In the case of the indorser of a negotiable promissory note, however, the liability does not become absolute unless due notice of non-payment is given to the party whom it is intended to charge.* That is not because the indorser has thus stipulated in terms, but it is a condition annexed by the rules of commercial law. In the case of a guarantor there is nothing to exempt him from the ordinary liability of parties who have broken their contracts, which is direct and not conditional. No condition requiring notice is inserted in the contract, nor is any inferred by any rule of law."

³⁷ *Trust Co. v. National Bank*, 101 U. S. 68 (1879). See *Aniba v. Ycomans*, 39 Mich. 171 (1878).

³⁸ *Hendrix v. Bauhard Bros.*, 138 Ga. 473, 75 S. E. 588 (1912). The prior cases were reviewed in the opinion in this case, in which it was said: "No reason appears why an indorser may not enlarge his liability, as well as limit it. The writing of his name upon the back of a negotiable note by the payee thereof constitutes an indorsement."

³⁹ In *Elgin City Banking Co. v. Zelch*, 57 Minn. 487, 59 N. W. 544 (1894), the brief opinion stated that: "Whether these indorsements be construed as constituting a single contract, or two distinct and separate contracts, we are clear that they constitute an 'indorsement,' in the commercial sense, and that the transferee is an 'indorsee' and entitled to protection as such, under the law merchant. The fact that Dunham enlarged his responsibility beyond that of 'indorser,' by guarantying payment, did not change or affect the character of his indorsement." See *Lemert v. Guthrie*, 69 Neb. 499, 95 N. W. 1046 (1903). *Pattillio v. Alexander*, 96 Ga. 60, 22 S. E. 646 (1895); *McNary et al. v. Farmers' National Bank*, 33 Okla. 1, 124 Pac. 286 (1912).

Where the payee "assigns and transfers the within note," it was said that "any one receiving it with such a transfer in blank may treat it as a blank

position recognizes that a purchaser of an instrument, on which such a guaranty is written, takes it free from defenses which the maker might interpose in an action brought by the payee.⁴⁰ In such cases it is important to note whether the action is against the defendant as maker, or the payee as indorser. If the action is brought against the payee as indorser, and he has in addition guaranteed the payment of the instrument, the above conflict is not apparent, but the payee-indorser-guarantor is held not to be an indorser, but a guarantor. His signature cannot make him liable both as indorser and guarantor.⁴¹

LIABILITY CREATED.

Having determined which one of these contractual obligations was assumed, the consequences must be considered. The principal will be liable not only to his creditor, but also in an action for reimbursement by the surety if the latter has paid the obligation for him. The indemnitor and warrantor will be liable to the person to whom the obligation was made, but they will be without the right to recover against anyone unless there is some contract permitting it.⁴² The obligee may, at his own option, and without notice of the principal's default, bring an action against the surety, who, after paying the obligor, in turn may recover from the principal the amount he has paid for him. If the instrument is construed as a joint and several contract, the obligee has the option to sue the surety alone, or jointly with the principal. The consequences in either case will be the same. While, as heretofore stated, the guarantor cannot be sued jointly with his principal, because liable on a separate and independent contract, he may be sued individually on his promise; and, if

indorsement and transfer it by delivery or may so fill it up as to make it a special indorsement." *Leahy v. Haworth*, 141 Fed. 850, 860, 73 C. C. A. 84 (1905).

⁴⁰ *Dunham v. Peterson*, 5 N. Dak. 414, 67 N. W. 293 (1896).

⁴¹ See Dean H. W. Arant's article in the 34 *YALE L. J.*, 144, 157 (1924), on the "Written Aspect of Indorsement." Also, *Allen v. Rightmire* (1823), 20 Johns. 365; *Lamouriex v. Hewit* (1830), 5 Wend. (N. Y.) 307; *Hough v. Gray*, (1838) 19 Wend. (N. Y.) 202; *Snevily v. Ekel* (1841), 1 Watts & S. 203. In *Brackets v. Rich*, 23 Minn. 485 (1807), the question was not raised, but the payee-guarantor-indorser was treated as a guarantor.

⁴² BRANDT, Sec. 5, 3d Ed. (1905).

recovery is had against him, he, in turn may sue his principal for reimbursement for his outlay on his account.⁴³

The surety then, being liable with the principal, and to the same extent, is entitled to no notice of the principal's default. Indeed, in the absence of statute, no indirect act, except a subsequent, valid, enforceable agreement between the obligee and the surety altering the original contract, or affecting the rights thereunder, will release the latter from his promise.⁴⁴ But with the guarantor, the situation is frequently different. To calculate the consequences of a guarantor's contracts, it is necessary to determine first, whether it is a negotiable or a non-negotiable instrument; second, whether it is an absolute or a conditional guaranty; third, whether it is a continuing guaranty.

Whether one who indorses nonnegotiable paper is the payee of it or a stranger, is very material in the presumption raised by such an indorsement.

"If the payee or assignee of paper, not negotiable, endorse his name in blank on the back of it, he is *prima facie* assignor, but if a stranger endorse his name in blank on the back of paper not negotiable, he is *prima facie* guarantor, but this presumption may be rebutted by showing the original understanding of the parties, by showing an express agreement otherwise, or by showing circumstances from which one may be inferred."⁴⁵

As heretofore explained, the liability of the guarantor is conditional upon the inability of the principal to pay. He is not, like the surety, liable from the beginning, but only after the principal defaults. Such being the character of his promise, the guarantor would not know, unless apprised by the obligee, that he had become liable under his promise. The guarantor is not bound at his peril to take notice of the non-performance of the

⁴³ *Beal v. Brown*, 13 Allen (Mass.) 114 (1866); *Lee and Co. v. Stowe and Wilmerding*, 57 Texas 444 (1882).

⁴⁴ *Courtis v. Dennis*, 7 Met. (Mass.) 510 (1844): "A surety is not, as a matter of course, entitled to notice, and is not discharged by the insolvency of the principal debtor, for want of notice, although the principal was solvent when the debt became due."

⁴⁵ *Kearns v. Montgomery*, 4 W. Va. 29, 40 (1870). See *Barden v. Hornthal et al.*, 151 N. C. 8, 65 S. E. 513 (1909).

principal's contract. A duty, therefore, is laid upon the obligee to notify the guarantor of the inability of the principal to pay. It is a condition precedent to recovery against the guarantor that he be notified by the obligee of the inability of the principal to pay, though it is not a condition precedent to the inception of his liability. Though potentially liable, failure to be notified may discharge the guarantor from this liability.⁴⁶ Two reasons may be noted for this recognized principle: (a) It is the implied agreement of the parties; (b) by the notice, the guarantor is enabled to protect himself by taking available steps to reimburse himself from the principal, or to be subrogated to the rights of the obligee against the principal.

But is the failure of the obligee to give the guarantor notice a bar to any recovery, or does he remain liable for a *pro tanto* share? The authorities are clear that failure to give the guarantor notice of the principal's inability to pay is not an absolute bar, but that the guarantor is discharged by such failure only to the extent that he can show he has been injured thereby. If the guarantor can establish no loss, he is not released. If he can show loss because he did not know of the principal's inability to pay, he is released to the extent of such loss only. There is not here any change of contract between the parties to discharge the guarantor such as exists when the obligee and principal enter into a valid agreement to extend time or alter the terms of their original contract. The contract between the principal and obligee remains as originally made. Unless by the obligee's failure to proceed against the principal he has injured the guarantor, there is no reason to release the latter from liability.⁴⁷

* "But, as we have seen, a guarantor—the surety in a contract of guaranty—is not primarily liable upon the principal's contracts, and only becomes liable upon his default. A guarantor, under this rule, is entitled to notice of the amount of his liability within a reasonable time after that liability is determined by the transaction between the original debtor and creditor." *Singer Mfg. Co. v. Littler*, 56 Ia. 601, 9 N. W. 905 (1881).

"But in regard to a guarantor, if the debt is not paid at maturity by the principal, who is solvent at the time, the guarantor will be discharged, if he has not received notice, if the principal shall have become insolvent, and, as a general rule, the guarantor is entitled to notice within a reasonable time; *Courtis v. Dennis*, 7 Met. (Mass.) 510 (1844).

* "Even in cases where notice is necessary, failure to give notice to the guarantor of the default of the principal would operate to release him from

Not only is the guarantor *pro tanto* discharged, if the creditor fails to notify him of the principal's default, but he is discharged to the extent of any loss he has sustained if the creditor fails to exercise due diligence in proceeding against the principal. Of course, the guarantor may by agreement dispense with this prerequisite, or, after the principal defaults, he may waive it.⁴⁸ And if the principal is insolvent, it would be useless to require that the obligee proceed against him. Since the law will not require a vain thing to be done, it may be shown by the obligee why he did not bring an action against the principal.⁴⁹

such loss only as he sustained by reason of that failure." *Booth v. Irving National Bank*, 116 Md. 668, 82 Atl. 652, 655 (1911); *Davis v. Wells*, 104 U. S. 159 (1881); *Lemmert v. Guthrie Bros.*, 69 Neb. 499, 95 N. W. 1046 (1903).

It was stated in *Brown v. Brooks*, 25 Pa. 210, 212 (1855), that: "Something more than demand and notice of non-payment is required to support an action on a guaranty. The contract for due diligence requires that a suit be brought within a reasonable time after the maturity of the claim, and be duly prosecuted to judgment and execution, before an action can be sustained against the guarantor, unless in cases where it is shown that such a proceeding could have produced no beneficial result. Where the principal debtor is insolvent at the maturity of the debt, no such proceeding is necessary as a foundation to an action on the guaranty. Nor is it necessary, in such a case, to show even a demand on the principal debtor, and notice of non-payment given to the guarantor. . . . Notice of non-payment is not an indispensable foundation of the action against the guarantor. Where this is omitted, and some loss or prejudice to the guarantor has been thereby produced, it will constitute a defense to the extent of such loss." See *McMillan et als. v. Bull's Head Bank*, 32 Ind. 11, 14 (1869).

" . . . for a failure to use such diligence as is necessary to fix the liability of an indorser does not absolutely discharge a guarantor, and he will be discharged in such case only to the extent he may have sustained loss or injury by the delay in enforcing the demand." *Burrow v. Zapp*, 69 Texas 474, 6 S. W. 783, 784 (1888).

In the opinion in *Jones v. Goodwin*, 39 Cal. 493 (1870), it was said: "No demand or notice is considered necessary as a condition precedent to fixing the liability of the guarantor, or to the commencement of the action; but a failure to make demand and give notice, together with proof of injury, is *pro tanto* a defense."

It was said in *Fuller v. Scott*, 8 Kans. 25, 32 (1871): "The guarantor is not released from liability for want of presentment, demand, and notice, unless he can show negligence in the holder of the note, and actual loss sustained by himself." See *Pitman v. Bidlecombe*, 4 Mod. 230 (1793).

* Lord Ellenborough, C. J., in *Warrington et al. v. Furber*, 8 East. 242 (1807), said: " . . . if the latter (the principal) become bankrupt and notoriously insolvent, it is the same as if they were dead; and it is nugatory to go through the ceremony of making a demand upon them." See *Stone v. Ruckerfeller*, 29 Oh. St. 625 (1876).

In the early case of *Reynolds v. Douglass*, 12 Peters 498, 503 (1838), the United States Supreme Court thus expressed its opinion: "The rule is well settled that the guarantor of a promissory note, whose name does not appear

THE GUARANTOR OF NEGOTIABLE INSTRUMENTS.

There is no difference between the guaranty of a nonnegotiable and a negotiable instrument so far as the operative facts are concerned. In both, the contract of the guarantor is separate from that of the principal; in both, a separate consideration must exist; in neither can the principal and guarantor be sued together; in both, the results, so far as the rights of the guarantor against the principal are concerned, are the same. As one court expressed it, "a contract of suretyship is necessarily included in every unqualified indorsement of a negotiable instrument."⁵⁰

In considering any case involving negotiable instruments, it is essential to determine whether it was decided according to the rule of the law merchant, or under the provisions of the Negotiable Instruments Law, now adopted in principle by all of the American States, the District of Columbia, Alaska, Hawaii, and the Philippine Islands.

The signature on the back of an instrument by the payee will be presumed to have been made for a different purpose than if the signature is that of a stranger. An instrument payable to a designated payee or order can be put into circulation as a negotiable instrument only by his indorsement;⁵¹ hence his name on the back would presume an indorsement. But one who is a stranger, and signs in such manner, would not necessarily sign for that purpose. As it was expressed in an opinion of the Supreme Court of Georgia:

"The payee or a subsequent indorsee alone can enter into the technical contract of indorsement, because they in succession alone have power to transfer or assign the paper; but any person may guaranty the solvency of the maker and be liable as guarantor."⁵²

on the note, is bound without notice, where the maker of the note was insolvent at its maturity. That his liability continues, unless he can show he has sustained some prejudice by want of notice of a demand on the maker of the note, and non-payment."

⁵⁰ *Tanner v. Gude*, 100 Ga. 157, 27 S. E. 938 (1897).

⁵¹ *Good v. Martin*, 95 U. S. 90 (1877).

⁵² *Pattillio v. Alexander*, 96 Ga. 60, 22 S. E. 646, 650 (1895).

Where a negotiable instrument is signed on the back by a stranger, called an accommodation or anomalous or irregular indorser, the courts have reached at least four different results.⁵³

(a) Some have held the presumption to be that a stranger who signed his name on the back of a negotiable instrument did so as a guarantor, where the action arose between him and the payee.⁵⁴

(b) Another line of authorities held, first, that if the name of one not the payee was found on a negotiable instrument, it was presumed to have been signed when the holder procured it; second, as this was a question of fact, parol evidence is admissible *only* to show whether or not the blank indorsement was made prior to or after delivery of the instrument; third, if the fact be found that the indorsement was on the instrument *before* it was delivered, it is *conclusive* that the one so signing is a joint maker, and parol evidence of a contrary intention cannot be received; fourth, that if the fact be found that the indorsement was made *after* delivery to the promisee, parol evidence is then admissible to prove separate consideration, which if established, makes the defendant liable as a guarantor.⁵⁵

(c) Some cases have taken the view that a blank indorsement by a stranger on the back of a negotiable instrument, when signed at the time it was made, or very soon thereafter, constituted the signer a surety. The reason is that it had a relation to the making of the contract originally, and the consideration of the maker will support the promise

⁵³ See 23 HARV. L. REV., 396 (1910).

⁵⁴ "The law presumes that the signature of appellant was placed on it at the time it was executed, and that, he being a stranger to the note, his contract was that of guarantor, the consideration for the note being the consideration for the guaranty. . . . " *Duncannon v. Kirby*, 90 Ill. App. 15, 17 (1899); *Milligan v. Holbrook*, 168 Ill. 343, 48 N. E. 157 (1897). The Ohio Supreme Court in *Castle v. Rickey*, 44 Oh. St. 490 (1886), held that a stranger who placed his name on the back of a promissory note, after delivery to the payee, was a *prima facie* guarantor, but said this presumption "may be overcome by parol evidence that a different agreement was intended." See DANIEL ON NEGOTIABLE INSTRUMENTS, Sec. 713-c, 6th Ed. (1919), and cases cited; *Ford v. Hendricks*, 34 Cal. 673 (1868).

⁵⁵ *Essex Co. v. Edmonds et al.*, 12 Gray (Mass.) 273 (1858); *Schneider v. Schiffman*, 20 Mo. 571 (1855); *Good v. Martin*, 95 U. S. 90, 24 L. Ed. 341 (1877). See DANIEL ON NEGOTIABLE INSTRUMENTS, Sec. 713-a, 6th Ed. (1919), and cases cited.

of the one signing his name on the back.⁵⁶ (d) Other courts have held such signing before delivery to the payee to constitute an indorsement.⁵⁷ This is the rule under the Negotiable Instru-

⁵⁶ In the opinion of the Ohio Supreme Court in *Ewan v. Brooks-Waterfield Co.*, 55 Oh. St. 596, 45 N. E. 1094, 1095 (1897), it was said: "Precisely what is the nature of the legal obligation contracted by a stranger who indorses his name in blank on the back of a negotiable promissory note before or at the time it takes effect is a question upon which the courts have widely differed; some holding that his liability is that of a second indorser; others have held him liable as a guarantor; and still others as a maker with the rights of a surety. The rule established in this state is that, when the name of such third party appears upon the note at the time it takes effect, his undertaking rests upon the consideration which supports the note; and the presumption is that he intended to be liable as surety for its payment, and is held accordingly, unless he can show that there was a different agreement or understanding between the parties which it is competent for him to do." See *Barden v. Hornthal*, 151 N. C. 8, 65 S. E. 513 (1909). See DANIEL ON NEGOTIABLE INSTRUMENTS, Sec. 713-b, 6th Ed. (1919).

An early Massachusetts case, *Mois v. Bird*, 11 Mass. 436 (1814), made this observation: "He puts his name upon a note, payable to another in consequence of a purchase made by his brother, in a day or two after the bargain was made, knowing that he could not be considered in the light of a common indorser, and that he was entitled to none of the privileges of that character."

The holder chooses to consider him as a surety, binding himself originally with the principal, and we think he has a right to do so. If he was a surety, then he may be sued as original promisor." *Josselyn v. Ames*, 3 Mass. 273 (1807); *Hooper v. Pritchard*, 7 Mo. 492 (1842); *Powell v. Thomas*, 7 Mo. 440 (1842); *contra*, *Fitzhugh v. Lowe's Executor*, 6 Call. (Va.) 5 (1806).

⁵⁷ "In some states, as in Massachusetts, Vermont and Louisiana, he is regarded as a surety or joint maker of the note, and unconditionally liable. In some states he is held to be a guarantor, and various efforts have been given in these states to the contract of guarantee, sometimes being held to be conditional, at other times absolute; and very frequently parol evidence is admitted to explain what the contract really was. In other states, as in New York, Tennessee, Iowa, and, we may add, California, he is held as indorser."

"The decisions in this state are substantially in accord with those which hold that one who, not being a party to a negotiable bill, indorses it in blank for the purpose of adding to its credit, is an indorser, and in view of the diversity of opinion on the subject we should not now feel inclined to disturb the doctrine, even if it did not meet our approval."

" . . . There seems to be no difference between the undertaking of a general guarantor and that of an indorser, except that the former, being a party to the note, his contract is construed by the law merchant, while the undertaking of the latter is construed by the general law of contracts. Each undertakes that the maker will pay the note at maturity; and in case of being compelled to pay it for the principal, each has recourse upon his principal to recover the amount paid, and there is no good reason why they should not have equal opportunities to secure themselves from the assets of the maker. The law merchant has established what is due diligence, and what is a reasonable time within which demand and notice should be made to bind an indorser, and upon principle the same diligence should be used to charge one who has assumed the same responsibility as a guarantor." *Jones v. Goodwin*, 39 Cal. 493 (1870). As to the view of the various states, where a person, not a party, places his name on the back of a note, see the notes following the above opinion as reported in 2 Am. Rep. 473, 475; also, 56 Am. Dec. 358.

ments Law;⁵⁸ and the logic of this view requires the exclusion of parol evidence as to the intent of the person signing.⁵⁹

Where the payee attempted to recover from the accommodation indorser, the rule worked well. But suppose the payee indorsed the instrument and by mesne transfers, he again came into possession as a holder in due course? The accommodation indorser is the first one, the payee being second, and subsequently became holder. The anomaly of circuitry of action is presented, which would allow an indorsee to sue the payee, who could then sue the accommodation indorser. The New York Court of Appeals worked out the fiction, first, that the payee is the first indorser, and second, that the payee is conclusively presumed to have indorsed the instrument *without recourse* to the accommodation indorser, who in turn indorsed it back to the payee, so that the latter is not liable on it to the accommodation indorser.⁶⁰ The necessity of determining whether the accommodation party signed as first or subsequent indorser does not arise in negotiable instruments executed after the Negotiable Instruments Law was adopted in any state, since it provides for his liability.⁶¹ Under that Act, parol evidence to show that the party signing otherwise than as maker, drawer or acceptor intended not to be held as indorser, is not admissible in an action

⁵⁸ The N. I. L., Sec. 63 provides: "A person placing his signature upon an instrument otherwise than as maker, drawer or acceptor, is deemed to be an indorser, unless he clearly indicates by appropriate words his intention to be bound in some other capacity." Sec. 64 provides in part: "Where a person, not otherwise a party to an instrument, places thereon his signature in blank before delivery, he is liable as indorser, in accordance with the following rules:

" See *Rockfield et al. v. First National Bank of Springfield*, 77 Oh. St. 311, 83 N. E. 392 (1907); *Baummeister v. Kuntz*, 53 Fla. 340, 42 So. 886 (1907).

These sections of the Negotiable Instrument Law apply only to irregular indorsers who place their signatures on the instrument *before delivery to the payee*. A plaintiff seeking the benefit of this act must bring himself within it by appropriate allegations. If the indorsement is *after delivery* of the instrument to the payee, the plaintiff must allege and sustain the burden of proving that the accommodation indorser signed his name in order to lend credit to the maker and with the intent of charging himself thereon to the payee. *Kohn v. Consolidated Butter and Egg Co.*, 63 N. Y. Supp. 265 (1900).

⁵⁹ *First National Bank v. Bickel et al.*, 143 Ky. 754, 137 S. W. 790 (1911).

⁶⁰ *Moore v. Cross*, 19 N. Y. 227 (1859). See *Temple v. Baker et al.*, 125 Pa. 634, 17 Atl. 516 (1889); *Eilbert v. Finkbeiner*, 68 Pa. 243 (1871). See the comments in 23 HARV. L. REV., 396 (1910), and DANIEL ON NEGOTIABLE INSTRUMENTS, Sec. 713-e, 6th Ed. (1919).

⁶¹ N. I. L., Sec. 64.

against him by the payee or indorsee,⁶² though parol evidence is admissible to show such an agreement between the indorsers themselves.⁶³

If the signature is placed on a negotiable instrument by a stranger a long time subsequent to that of the maker, and after delivery, clearly the liability is not that of a surety. It was, prior to the Negotiable Instruments Law, a guaranty. Consideration to support the promise must exist, but it could be proven by parol.⁶⁴ Under the Negotiable Instruments Law, this would doubtless be presumed to be an indorsement,⁶⁵ and, furthermore, the indorsement would be presumed to have been made prior to maturity.⁶⁶

Under the Negotiable Instruments Law, in some of the cases prior to its enactment, an indorsement on the back by the payee that "I herewith transfer and assign all my right, title and interest to the within note," is a qualified indorsement, the same as if the indorser had used the phrase "without recourse." It is an effective transfer of the instrument to the indorsee. It cuts off the defenses of the maker, but fails to confer any rights against the indorser.⁶⁷ But a few cases have held such an indorsement

⁶² First National Bank v. Bickel, 143 Ky. 754, 137 S. W. 790 (1911).

⁶³ Wilson v. Hendee, 74 N. J. L. 640, 66 Atl. 413 (1907); Haddock, Blanchard and Co. v. Haddock, 192 N. Y. 499, 85 N. E. 682 (1908).

⁶⁴ "When the guaranty is contemporaneous with the execution of the instrument, it is not necessary that there should be any consideration, other than that for which the note is evidence. But where, as in this case, the alleged guaranty was made long after the execution and delivery of the note, although before due, there must be some new consideration. Like all valid contracts, there must be a consideration to support it. And there can be no presumption of a consideration. It must be proved." Tucker v. Gentry, 93 Mo. App. 655, 67 S. W. 723, 724 (1902).

Chief Justice Shaw said in *Essex Co. v. Edmonds et al.*, 12 Gray (Mass.) 273 (1858): "Therefore, if the note was thus indorsed in blank, after it was delivered by the promisor to the promisee, it could not be a contract made upon the original consideration of advancing the money on the note, and participating in the same consideration with the promisor. . . ."

"Being a blank indorsement, of course no consideration appears on the face of it; but if it was put on after delivery, an instrument so indorsed in blank authorized the holder to go into proof of the fact which such blank shows was intended to be supplied. It may be proved by parol testimony that there was a consideration as between the holder and guarantor, and what that consideration was, and the blank filled accordingly."

⁶⁵ N. I. L., Sec. 63.

⁶⁶ N. I. L., Sec. 45.

⁶⁷ See article by Dean H. W. Arant, 34 YALE L. J., December, 1924, p. 144; *Spencer v. Halpern*, 62 Ark. 595, 37 S. W. 711 (1896); *Hammond Lumber Co.*

throws suspicion upon the transaction, destroys the negotiable character of the paper, is only an assignment, and the transferee takes it subject to the equities of the original parties.⁶⁸

But where one of two joint payees of a note merely assigns and transfers his interest and title to the other joint payee, who in turn indorses it to a holder in due course, the first joint payee so assigning is liable to such holder as an ordinary indorser; and any fact which might be a defense between the joint payees cannot be set up in an action brought by a *bona fide* holder. Both joint payees must indorse a note to negotiate it.⁶⁹ One joint payee, by assigning his interest in the instrument to the

v. Kearsley, 36 Cal. App. 431, 172 Pac. 404 (1918); Evans v. Freeman, 142 N. C. 61, 54 S. E. 847 (1906); Merrill v. Hurley *et al.*, 6 S. Dak. 592, 62 N. W. 958 (1895).

A decision under the Negotiable Instruments Law, where the payee of a note, wrote on the back of it, "I here by assign this note," and signed his name, held the payee to be an indorser, and the makers could not set up the defenses against a holder in due course, which could be set up against the payee. Confusion prior to and after the Negotiable Instruments Law was admitted. The opinion states: "The authorities seem to be in utter and hopeless confusion concerning the effect of the transfer of a negotiable instrument by words like those used here. The confusion existed prior to the passage of the uniform Negotiable Instruments Law, and still exists. The weight of authority was and is, that this is a commercial indorsement. We are of the opinion that the 'assignment' of this note is an indorsement thereof, under the Negotiable Instruments Law; that Farnsworth is a holder in due course; and that the makers of the note cannot set up the defenses against the note that could have been set up against it in the hands of Wheeler." Farnsworth v. Burdick, 94 Kan. 749, 147 Pac. 853 (1915). The same court the year previous held that where the payee wrote on the back of a note, "I hereby assign the within note and coupons, together with all my interest in and all my rights . . . without recourse," it was an assignment, and not an indorsement, and the transferee took only the rights of the payee. Nelson v. Southworth, 93 Kan. 532, 144 Pac. 835 (1914). See also Markey v. Corey, 108 Mich. 184, 66 N. W. 493 (1895).

DANIEL ON NEGOTIABLE INSTRUMENTS, Sec. 688-c, 6th Ed. (1919), did not take this view of it, though admitting "the question arising in such cases is a nice one." The author said: "Does the writing over a signature on express assignment which the law imports from the signature *per se* exclude and negative the idea of conditional liability which the law also imports if such assignment were not expressed in full? We think not. . . . Did the payee intend merely to pass the title he should use the words 'without recourse' or some phrase of equal import. His liability is implied without words expressly creating it. To be negated, words should be used which negate the implication." See Maine Trust and Banking Co. v. Butler, 45 Minn. 506, 48 N. W. 333 (1891); Leahy v. Haworth, 141 Fed. 850, 73 C. C. A. 84 (1905); Sears v. Lantz *et al.*, 47 Ia. 658 (1878); Markey *et al.* v. Corey, 108 Mich. 184, 66 N. W. 493 (1895); Copeland v. Burk, 59 Okla. 219, 158 Pac. 1162 (1916).

⁶⁸ Aniba v. Yeomans, 39 Mich. 171 (1878); Gale v. Mayhew, 161 Mich. 96, 125 N. W. 781 (1910); Hatch v. Barrett *et al.*, 34 Kan. 223, 8 Pac. 129 (1885).

⁶⁹ N. I. L., Sec. 41. Voris v. Schoonover *et al.*, 91 Kan. 530, 138 Pac. 607 (1914).

other joint payee, authorizes the latter to indorse for him, which when done, makes both indorsers.⁷⁰

However, if the payee indorses the note in due course, stating "I guarantee payment of the within note, and waive demand, notice and protest," it was held to be an indorsement, and the indorser liable as such. The reasoning was that in a guaranty, in the jurisdiction deciding the case, no demand or notice of non-payment was necessary to fix the guarantor's liability. Presuming the parties used the clause waiving notice for some purpose, and such language being unnecessary if a guaranty was intended, but effectuating a purpose if the defendant intended to be an indorser, the court held the above constituted an indorsement.⁷¹

In cases of negotiable instruments, not controlled by the Negotiable Instruments Law, it has been held quite uniformly that one who signs his name on the back, impliedly authorizes the payee to write over his name such contract as is consistent with the agreement of the parties. For instance, if one not a party to a promissory note, indorses it in blank, the payee has implied authority to overwrite the signature: "I guarantee the prompt payment of the within note at maturity with interest." Since the contract created by such accommodation indorsement was then interpreted to be a guaranty, the payee was warranted in writing an express guaranty over the signature.⁷² The effect of an indorsement in blank of a negotiable instrument was thus stated by the Kansas Supreme Court:

"We decide the questions raised upon these instructions as follows:

"*First.* The indorsement of the name of a third person in blank upon the back of a promissory note is *prima facie* evidence of a contract of guaranty. . . .

⁷⁰ *Citizens National Bank v. Walton*, 96 Va. 435, 31 S. E. 890 (1898); DANIEL ON NEGOTIABLE INSTRUMENTS, Sec. 684, 6th Ed. (1919).

⁷¹ *Delsman v. Friedlander et al.*, 40 Oregon 33, 66 Pac. 297 (1901); *Mangold and Glandt Bank v. Utterback*, 54 Okla. 655, 160 Pac. 713 (1916).

⁷² *Duncanson v. Kirby*, 90 Ill. App. 15 (1899). Accord, *Mizner v. Spier*, 96 Pa. 533 (1880); *Zahm v. First National Bank of Lancaster*, 103 Pa. 576 (1883); *Hartman v. First National Bank*, 103 Pa. 581 (1883).

"*Second.* Such an indorsement gives to the holder of the note full authority to fill up the blank at any time, before or during the trial, with the implied contract of guaranty, unless the same is inconsistent with the understanding of the parties.

"*Third.* It is necessary that there be a consideration to support the guaranty. An agreement to extend the time of payment of the note is a sufficient consideration to sustain the guaranty.

"*Fourth.* Such an indorsement is such a contract in writing as will import a consideration, . . . and if the party who made the indorsement claims that there was no consideration for the guaranty, the burden of proof will rest upon him to show it, and he must show it by a preponderance of the evidence." ⁷³

But while the instrument itself is negotiable, the guaranty on the back of it is not negotiable.⁷⁴ Neither is the guaranty negotiable if made on a separate paper and addressed to a particular person.⁷⁵ The reason for this rule, as well stated by the Supreme Court of Kansas, is that:

"It cannot be said that the guaranty of an instrument by a person who did not *execute* the instrument, who was never liable on it, and who never *owned* it or *held* it, in legal contemplation is a *negotiable indorsement* of the instrument, or a *negotiable guaranty* of the same; and therefore, when the instrument so guaranteed is afterwards transferred to another person, whether by an indorsement of the instrument or otherwise, only the rights of the guarantee as against the guarantor are transferred by the guarantee to such other person." ⁷⁶

⁷³ Fuller v. Scott, 8 Kan. 25, 32 (1871).

⁷⁴ Edgerly v. Lawson *et al.*, 176 Mass. 551, 57 N. E. 1020 (1900), says: "It is also clear that a guaranty is here considered a non-negotiable chose in action, although written by a third person on the back of a negotiable promissory note." Smith v. Dickinson, 6 Humph. (Tenn.) 261 (1845); Hayden *et al.* v. Weldon, 43 N. J. L. 128 (1881).

⁷⁵ Vultz *et al.* v. National Bank of Illinois, 158 Ill. 532, 42 N. E. 69, 72 (1895).

⁷⁶ Briggs v. Latham, 36 Kan. 205, 13 Pac. 129, 132 (1887).

The guaranty, however, is assignable, and follows the principal obligation, even if evidenced by a promissory note. If it be a general guaranty, *i. e.*, open to acceptance by the public generally, and not a special guaranty, limited to the person addressed, it is enforceable by any one who can enforce the principal obligation, subject to such defenses which may be interposed to any assignment.⁷⁷ The same result is reached in case of the guaranty of a non-negotiable instrument.⁷⁸

DEFENSES AVAILABLE TO ACCESSORIAL OBLIGORS.

Before the Negotiable Instruments Law, there were certain acts which, if the obligee were a party to them, would discharge the surety or guarantor of any instrument, whether negotiable or not. Such, for instance, would be a valid agreement between the obligee and principal to extend the time of payment.⁷⁹ The Negotiable Instruments Law does not contain either the word surety or guarantor though indorser is frequently used.⁸⁰ That law provides certain methods by which those primarily and secondarily liable on negotiable instruments may be discharged.⁸¹ It also provides that "the person 'primarily' liable on an instrument is the person who by the terms of the instrument is absolutely required to pay the same. All other parties are 'secondarily' liable."⁸² The courts have decided, in interpreting the applicable sections of the Negotiable Instruments Law that the act having provided specific methods for the discharge of persons primarily liable, the rule *expressio unius est exclusio alterius* applied, and a surety, being primarily liable, is not discharged by "a contract

⁷⁷ *Tidioute Savings Bank v. Libbey et al.*, 101 Wis. 193, 77 N. W. 182 (1898).

⁷⁸ *Bassett v. Perkins et al.*, 65 Misc. Rep. 103, 119 N. Y. S. 354, 359 (1909).

⁷⁹ *Samuell v. Howarth*, 3 Merivale 272 (1817).

⁸⁰ *Union Trust Co. v. McGinty*, 212 Mass. 205, 98 N. E. 679 (1912), says: " . . . no relation of principal and surety is established by any of its sections."

⁸¹ N. I. L., Secs. 119-120.

⁸² N. I. L., Sec. 192. *Northern State Bank of Grand Forks v. Bellamy*, 19 N. Dak. 509, 125 N. W. 888 (1910).

between the holder of the instrument and the principal for the extension of time of payment, although upon a valuable consideration, and without the consent of the surety." ⁸³ A surety

⁸³ *Richards v. Market Exchange Bank Co.*, 81 Oh. St. 348, 90 N. E. 1000 (1909).

The same conclusion was reached in an action by the payee against one whom plaintiff knew to be a surety, though it did not so appear in the instrument, in *Vanderford v. Farmers and Mechanics National Bank of Westminster*, 105 Md. 164, 66 Atl. 47 (1907). See also *Cowan v. Ramsey*, 15 Ariz. 533, 140 Pac. 501 (1914); *Elsev v. People's Bank of Bardwell*, 168 Ky. 701, 182 S. W. 873 (1916); *Jamesson v. Citizens' National Bank of Westernport*, 130 Md. 75, 99 Atl. 994 (1917); *Lane v. Hyder et al.*, 163 Mo. App. 688, 147 S. W. 514 (1912); *Cleveland National Bank v. Bickel et al.*, 59 Okla. 279, 159 Pac. 302 (1916).

The same conclusion would naturally follow where the defendant added the word surety after his name. *Cellers et al. v. Meachem et al.*, 49 Oregon 186, 89 Pac. 426 (1907).

In an action by the indorsee against the surety on a negotiable instrument, the latter is not released by a valid agreement between a holder and the principal to extend time, though without the surety's knowledge. *Wolstenholme v. Smith et al.*, 34 Utah 300, 97 Pac. 329 (1908); *Murphy v. Panter et al.*, 62 Oregon 522, 125 Pac. 292 (1912).

The maker of an accommodation note was not released by an agreement between a holder in due course and the accommodated party extending time of payment in *National Citizens' Bank of N. Y. v. Toplitz*, 81 App. Div. 593, 81 N. Y. S. 422 (1903), and affirmed in 178 N. Y. 464 on another ground, the Court of Appeals saying the question of discharge under the Negotiable Instruments Law "is an interesting one which we do not deem it necessary to discuss at this time." See *Bradley Engineering Co. v. Heyburn et al.*, 56 Wash. 628, 106 Pac. 170 (1910).

The Tennessee Supreme Court refused to release the accommodation maker, in an action by the payee against the accommodation maker, where the payee and principal extended time by a valid agreement. *Graham v. Shephard*, 136 Tenn. 418, 189 S. W. 867 (1916).

In apparent contradiction is the opinion of Mr. Justice Grace in *Scandinavian American Bank of Fargo v. Westby*, 41 N. Dak. 276, 172 N. W. 665 (1819): "Though the surety is primarily liable, that does not relieve the creditor or the holder of the note from liability if he does not use ordinary diligence in preserving the security which has been hypothecated to secure the payment of the note, nor (in the opinion of the writer) can the creditor and the principal debtor, by agreement between themselves without the knowledge or consent of the surety, extend the time of payment to a time certain, thus, in effect, making a new contract, and if such is done the liability of the surety, in my opinion, ceases." The weight of this opinion is lessened when it is noted that of the five judges one dissented, and of the four who concurred in the conclusion, the other three do not appear to have assented to this reasoning. Two expressly dissent from the reasoning, though concurring in the result reached.

The Iowa Supreme Court in *Fullerton Lumber Co. v. Snouffer*, 139 Ia. 176, 117 N. W. 50 (1908), specifically confining its decision to an action by the payee against the surety-maker, held that an extension of time by enforceable agreement with the principal, released the surety. The Missouri Court of Appeals made the same distinction in an action brought by the payee against the accommodation maker. *Long v. Shafer et al.*, 185 Mo. App. 641, 171 S. W. 690 (1914).

Professor Brannan in his work on Negotiable Instruments, 313, 3d Ed. (1920), is critical of the prevailing view, as stated in the text of the article, which is followed by most of the states, and gives his view in this language:

on such a negotiable instrument has an absolute liability to pay under Section 192 of the Negotiable Instruments Law, and can be discharged only by one of the methods enumerated in Section 119 of that act.

However, one not a party to the instrument, who writes on the back of a note, "for value received, I hereby guarantee the payment of the within note," and signs his name, is a guarantor, and under the provisions of Section 120-6 of the Negotiable Instruments Law is discharged from liability by the execution of a valid contract for the extension of time made between the holder and the principal to which he did not consent.⁸⁴ This is because the guarantor is recognized by the Negotiable Instruments Law to be secondarily liable.⁸⁵

ABSOLUTE AND CONDITIONAL GUARANTORS.

The liability of the guarantor will depend upon the kind of a guaranty which is made. Such guaranty, with reference to the kind of obligation assumed when the agreement is made, may be either absolute or conditional. It is essential that these two be distinguished in order to understand the cases.

"An absolute guaranty is 'an unconditional undertaking on the part of the guarantor that the maker will pay the note.' A conditional guaranty is 'an undertaking to pay if payment cannot by reasonable diligence, be obtained from the principal debtor.'"⁸⁶

"It is submitted that the decisions in these cases are at variance with well established doctrines of suretyship, . . . and are not required by the provisions of §§ 119 and 120. The discharge of a party, who, though primarily liable, is known to the holder to be a surety, by giving time to the principal debtor seems to be covered by §119-4. But if this is not so, then, since the discharge of a surety-maker or surety-acceptor by an extension of time granted to the principal by a holder with knowledge of the relation, is neither a discharge of the instrument nor a discharge of a party secondarily liable, this should be regarded as an omitted case and, therefore, to be governed by the law merchant under §196."

The majority rule was also criticized by Professor C. D. Henning in 59 U. OF PA. L. REV., 532.

⁸⁴ *Northern State Bank of Grand Forks v. Bellamy*, 19 N. Dak. 509, 125 N. W. 888 (1910). See N. I. L., Sec. 119.

⁸⁵ See *Crawford v. Turnbaugh*, 86 Oh. St. 43, 98 N. E. 858 (1912).

⁸⁶ *Beardsley v. Hawes et al.*, 71 Conn. 39, 40 Atl. 1043, 1044 (1898); *Cownie v. Dodd*, 167 Ia. 627, 149 N. W. 904 (1914).

What has been said concerning the discharge of a guarantor of an instrument negotiable or non-negotiable will not apply if the guaranty is absolute. The absolute guarantor is liable from the moment the principal fails to perform as agreed, and is not entitled to notice of the principal's default, without express agreement. This is true because:

"When a guarantor makes an absolute promise that any particular thing shall be done, he thereby assumes an active, absolute duty to see that it is done, and must, at his peril, perform the promise."⁸⁷

The absolute guarantor's liability is commensurate with that of the principal and whatever proof will establish the liability of the principal will establish that of the guarantor.⁸⁸

By writing on the back of a promissory note, "I hereby warrant the within note good and collectible until paid," the guarantor's liability is absolute. The holder is not required in such case to give notice of the principal's default or proceed against him seasonably. The reason is that by his contract, the guarantor has agreed to be liable absolutely on the principal's default "until paid," which constitutes an absolute guaranty.⁸⁹ Had the guarantor omitted the words "and collectible," used in the above, simply guaranteeing the note to be good until paid, his obligation would have been a conditional one, and to recover, the holder must allege and prove that steps were taken to collect from the maker, or that the note was not collectible from him.⁹⁰ If the guarantor had written instead, "I hereby guaranty the

⁸⁷ *Lefkovitz v. First National Bank of Gadsden*, 152 Ala. 521, 44 So. 613, 615 (1907); *Heyman v. Dooley*, 77 Md. 162, 26 Atl. 117 (1893); *Booth v. Irving National Exchange Bank*, 116 Md. 668, 82 Atl. 652 (1911); *Hubbard v. Haley et al.*, 96 Wis. 578, 71 N. W. 1036 (1897).

⁸⁸ *Great Western Printing Co. v. Belcher*, 127 Mo. App. 133, 104 S. W. 894 (1907); *March v. Putney*, 56 N. H. 34 (1875).

⁸⁹ *Lenmon et al. v. Strong*, 55 Conn. 443, 13 Atl. 140 (1888); *Loomis Inst. v. Hurd*, 57 Conn. 435, 18 Atl. 669 (1889); *Brown v. Wilcox*, 73 Conn. 100, 46 Atl. 827 (1900); *The Woodstock Bank v. Downer*, 27 Vt. 539 (1855).

The same principle is applicable in the case of a guaranty of a non-negotiable instrument. *Garland v. Gaines*, 73 Conn. 662, 49 Atl. 19 (1901); *Pleasantville Mutual Loan and Building Society v. Moore et al.*, 70 N. J. L. 306, 57 Atl. 1034 (1904).

⁹⁰ *Cowles, Executor v. Peck*, 55 Conn. 251, 10 Atl. 569 (1887). But see *Donley v. Camp*, 22 Ala. 659 (1853).

payment of the within note," he would likewise be liable without notice of default, from the moment the maker failed to pay as agreed.⁹¹ But even though the defendant unqualifiedly guarantees the payment of an instrument, if the sum due is uncertain, the time of limitation for payment by the principal not fixed, or the liability to be determined by the settlement of accounts, he is entitled to notice before he incurs any liability in an action.⁹² A guaranty, supported by a consideration, written on the back of a promissory note, or on a separate paper to pay "at maturity,"⁹³ or "to remain in full force until the debt now due is fully discharged,"⁹⁴ or "this bill will be paid in fifteen days,"⁹⁵ obliges the promisor to pay without notice by the payee, and without requiring diligence on the part of the payee to collect from the principal. It is the duty of an absolute guarantor to notice the fact that the debt is unpaid.⁹⁶

GUARANTY OF PAYMENT AND GUARANTY OF COLLECTIBILITY.

Distinction between a guaranty of payment and guaranty of collectibility should be noted. The former is absolute, and no notice of the principal's default to the promisor need be given; the latter is conditioned on proper notice and due diligence by the obligee. The undertakings of the two guarantors are different, hence the prerequisites to their liability are not the same. As the New York Court of Appeals stated:

"The fundamental distinction between a guaranty of payment and one of collection is, that in the first case the guarantor undertakes unconditionally that the debtor will pay, and the creditor may, upon default, proceed directly against the guarantor, without taking any steps to collect of the principal debtor, and the omission or neglect to

⁹¹ *Roberts v. Hawkins*, 70 Mich. 566, 38 N. W. 575 (1888).

⁹² *Courtis v. Dennis*, 7 Met. (Mass.) 510, 518-519 (1844).

⁹³ *Fegley v. Jennings*, 44 Fla. 203, 32 So. 873 (1902); *McKibben et al. v. Ripley et al.* (Neb.), 95 N. W. 1046 (1901); *Roberts et al. v. Riddle*, 79 Pa. 468 (1875). See *Clay v. Edgerton*, 19 Oh. St. 549 (1869).

⁹⁴ *Cowan, McClung and Co. v. Roberts*, 134 N. C. 415, 46 S. E. 979 (1904).

⁹⁵ *Stewart, Gwynne and Co. v. Sharp County Bank*, 71 Ark. 585, 76 S. W. 1064 (1903).

⁹⁶ *Heyman v. Dooley*, 77 Md. 162, 26 Atl. 117 (1893); *Tilt-Kenney Shoe Co. v. Haggarty et al.*, 43 Tex. Civ. App. 335, 114 S. W. 386 (1906).

proceed against him is not (except under special circumstances) any defense to the guarantor; while in the second case the undertaking is that if the demand cannot be collected by legal proceedings the guarantor will pay, and consequently legal proceedings against the principal debtor, and a failure to collect of him by those means are conditions precedent to the liability of the guarantor; and to these the law, as established by numerous decisions, attaches the further condition that due diligence be exercised by the creditor in enforcing his legal remedies against the debtor."⁹⁷

From this it is obvious that it is quite material to determine whether the guaranty is absolute, conditional, or whether it be one of payment or a guaranty of collectibility. If it is absolute, or if it is a guaranty of payment, no notice of the principal's failure to pay need be given, because the guarantor by his promise agreed to become absolutely liable without the performance of any conditions.⁹⁸ Also, no diligence by the obligee to collect from the principal is prerequisite to the liability of the absolute guarantor.⁹⁹ The statute of limitations begins to run as soon as the cause of action accrues. In an absolute guaranty, the cause accrues when the principal defaults; in case of a conditional

⁹⁷ *Rapallo, J.*, in *McMurray v. Noyes*, 72 N. Y. 524, 28 Am. Rep. 180 (1878).

Subsequently the North Carolina Supreme Court emphasized the same distinction, saying: "There is a well-defined distinction between a guaranty of payment and a guaranty for the collection of a debt—the former being an absolute promise to pay the debt at maturity, if not paid by the principal debtor, when the guarantee may bring an action at once against the guarantor; and the latter being a promise to pay the debt upon condition that the guarantee diligently prosecutes the principal debtor for the recovery of the debt without success." *Cowan, McClung and Co. v. Roberts*, 134 N. C. 415, 46 S. E. 979, 980 (1904); *Cownie v. Dodd et al.*, 167 Ia. 627, 149 N. W. 904 (1914). See also *Evans v. Bell*, 45 Tex. 553 (1876); *Heyman v. Dooléy*, 77 Md. 162, 26 Atl. 117 (1893); article on *Demand on Principal Before Action Against Guarantor*, by W. P. Rogers, 6 Col. L. Rev., 229 (1906).

In *Merritt v. Haas*, 106 Minn. 275, 118 N. W. 1023 (1908), it was said that: "A distinction is made in contracts of this kind between guarantors of collection and absolute guarantors of payment. As to the former, the creditor is under certain obligations to protect the guarantor. . . . But the rule does not apply to an unconditional undertaking to pay if the principal debtor fails to do so."

⁹⁸ *Providence Machine Co. v. Browning et al.*, 68 S. C. 1, 46 S. E. 550 (1903); *Read v. Cutis*, 7 Greenleaf (Me.) 186 (1831).

⁹⁹ *Penny v. Crane Brothers Mfg. Co.*, 80 Ill. 244 (1875); *Home Savings Bank of Fremont v. Shallenberger*, 95 Neb. 593, 146 N. W. 903 (1914); *Clay v. Edgerton*, 19 Oh. St. 549 (1869); *Loverin and Browne v. Travis*, 135 Wis. 322, 115 N. W. 829 (1908).

guaranty, no right of action arises, and hence the statute of limitations does not begin to run, until after the payee has made an effort to collect from the defaulting principal, and the guarantor has been given notice of such failure to pay.¹⁰⁰

Thus it is seen that there are two differences between the obligation of a surety and that of an absolute guarantor: First, the absolute guarantor cannot be sued jointly with the principal; the surety can be joined with the principal. Second, the absolute guarantor's liability does not begin necessarily with his promise, but with the default of his principal; the surety's liability is co-existent and contemporaneous with that of the principal. The liability of a surety, guarantor and indorser of a *negotiable instrument* differs in that while the guarantor and indorser are secondarily liable,¹⁰¹ the surety, acceptor, maker, and principal are primarily liable.¹⁰² The contracts of a guarantor and indorser are made with reference to another contract, which is the principal one; but both are separate from that of the maker; while the surety's contract also refers to that of the principal, it is not a separate one. In the case of the guarantor, he is merely security for the payment of the principal obligation; the indorser both transfers title to the paper, and also becomes liable for the default of the maker or drawer.

¹⁰⁰ "There is a well-understood difference between a guaranty of payment, and a contract of indemnity against loss, as the result of the nonpayment of a debt. In the first case the liability of the guarantor is fixed by the failure of the principal debtor to pay at maturity, or at the time when the payment was guaranteed. In the second the contract partakes of the nature of a guaranty of collection, no liability being incurred until after, by the use of due and reasonable diligence, the guarantee has become unable to collect the debt from the principal debtor. A guaranty of collection, or a guaranty against loss as a result of the failure to collect a debt, places upon the one for whose benefit the guaranty is made the duty of making a reasonable effort to collect the debt from the principal debtor; and a cause of action does not accrue thereon until after such effort has been made, and proved unavailing. There is no right of action upon such contingent liability immediately upon the failure of the principal to perform." *Burton et al. v. Dewey et al.*, 4 Kan. App. 589, 46 Pac. 325 (1896); *Pierce et al. v. Merrill et al.*, 128 Cal. 464, 61 Pac. 64 (1900).

¹⁰¹ In *Rockfield v. First National Bank of Springfield*, 77 Oh. St. 311, 83 N. E. 392 (1907), it was said that "an indorser is not a maker or drawer; not one primarily liable."

¹⁰² See DANIELS ON NEGOTIABLE INSTRUMENTS, Secs. 532, 1236, 6th Ed. (1919).

As to the drawer of a bill of exchange, prior to its acceptance, his liability appears to be primary, while after acceptance, it becomes secondary. See NORTON ON BILLS AND NOTES, 119, 4th Ed. (1914).

PARTICULAR DEFENSES IN THE PRINCIPAL'S CONTRACT SET UP BY THE SURETY AND GUARANTOR, CONDITIONAL OR ABSOLUTE.

But the defenses which will release the indorser are entirely different from those available to the guarantor. This is because of the difference in the two contracts. The guarantor promises to pay if the obligee can not recover from the principal. This presupposes (a) diligence on the part of the obligee to collect from the principal, and (b) notice to the guarantor. Failure to perform this duty by the obligee will release the guarantor only to the extent he has been injured thereby. But the drawer and indorser of a foreign bill of exchange are absolutely discharged for failure to protest it,¹⁰³ or generally for failure to present any negotiable instrument for payment,¹⁰⁴ or to give notice of the non-acceptance or dishonor of any negotiable instrument.¹⁰⁵ Both the guarantor and indorser, being "secondary parties," will be absolutely discharged from liability on any negotiable instrument by the discharge of the instrument, cancellation of his signature, discharge of a prior party, release of the principal without reservation of right against the person secondarily liable, or by any binding contract between the holder and the principal to extend the time for payment.¹⁰⁶ The indorser's liability is an outgrowth of the law merchant which held that his contract "is to pay upon demand by the holder upon the drawer, and notice of nonpayment or of dishonor to him."¹⁰⁷

The surety assumes a primary liability, and in the absence of statute, the obligee is not required to exercise due diligence to collect from the principal. is not required to demand payment

¹⁰³ See N. I. L., Secs. 118 and 152.

¹⁰⁴ In Sec. 70, N. I. L., it is provided that "except as herein otherwise provided, presentment for payment is necessary in order to charge the drawer and indorsers."

¹⁰⁵ N. I. L., Sec. 89.

¹⁰⁶ N. I. L., Sec. 120.

¹⁰⁷ *Pattillio v. Alexander*, 96 Ga. 60, 22 S. E. 646, 647 (1895), which adds: "And, if he fail to perform this duty to give timely notice of nonpayment, the law presumes injury to the indorser, and discharges him."

from the principal, and need not give notice of his principal's default.¹⁰⁸ So far as negotiable instruments are concerned, a surety, being primarily liable, under the Negotiable Instruments Law, can be discharged only by the payment of the instrument in due course, its cancellation, by an act which would discharge a simple contract, or when the principal becomes holder in his own right after maturity.¹⁰⁹ But the common law defenses available to a surety are not changed in the case of nonnegotiable instruments.

It is well settled that a surety remains liable even though the principal be discharged because of being a married woman incapable of contracting,¹¹⁰ an infant,¹¹¹ a person *non compos mentis*,¹¹² a corporation whose contract is *ultra vires*,¹¹³ or if the principal's contract be unenforceable because it is not in writing as required by the statute of frauds.¹¹⁴ Neither is the surety on a building contract discharged if the obligee has failed to record the building contract, where such failure by statute makes it void, and the surety has not stipulated that it must be recorded.¹¹⁵ The defense of the principal in such cases is personal to him, and affords no ground for the surety to escape liability, even though he was ignorant of the facts. The disability of the

¹⁰⁸ This statement is correct unless altered by statute, as has been done in some states, and except under the rule of *Pain v. Packard*, 13 Johns. (N. Y.) 174 (1816), which took the view that if the surety specially request the obligee to proceed against the principal, and he fails to do so, the surety is relieved from liability to the extent of the loss. But, as pointed out in *Harris v. Newell*, 42 Wis. 687 (1877), *Pain v. Packard* "was decided without argument, and that two, at least, of the judges who concurred in it, afterwards expressly dissented from it."

¹⁰⁹ N. I. L., Sec. 119.

¹¹⁰ *Davis et al. v. Statts*, 43 Ind. 103 (1873); *Winn v. Sanford*, 145 Mass. 302, 14 N. E. 119 (1887); *Nabb v. Koontz*, 17 Md. 283 (1851); *Wiggins' Appeal*, 100 Pa. 155 (1882); *Smyley v. Head et al.*, 2 Rich. L. (S. C.) 590 (1845); *St. Albans Bank v. Dillon*, 30 Vt. 122 (1857).

¹¹¹ But if the infant-principal disaffirms his contract seasonably, and restores to the obligee the consideration, the surety is discharged from liability. *Baker v. Kennett*, 54 Mo. 82 (1873).

¹¹² *Lee v. Yandell*, 69 Tex. 34, 6 S. W. 665 (1887).

¹¹³ *Weare v. Sawyer*, 44 N. H. 198 (1862); *Bell v. Kirkland*, 102 Minn. 213, 113 N. W. 271 (1907); *Mason v. Nichols*, 22 Wis. 360 (1867).

¹¹⁴ *Backus v. Fecks et al.*, 71 Wash. 508, 129 Pac. 86 (1913). But see *Kansas City v. O'Connor et al.*, 82 Mo. App. 655 (1899).

¹¹⁵ *Kiessig v. Allspaugh et al.*, 99 Cal. 452, 34 Pac. 106 (1893).

principal may be the very reason why a surety was required.¹¹⁶ Incapacity of the principal after the execution of the contract of suretyship and before default, if caused by operation of law, or an act of God, as insanity, may release the surety.¹¹⁷

However, if fraud or duress is imposed on the principal, it is a defense to the surety in a majority of jurisdictions, though cases to the contrary exist.¹¹⁸ To be a defense available to the surety, he must show affirmatively that he was ignorant of the fraud or duress on the principal when he signed the contract as surety. Should he fail to aver or prove his innocence, he will not be discharged.¹¹⁹ The cases involving the incapacity of the principal are considered to present defenses personal to him, and unavailable to the surety, while duress and fraud inhere in the contract, and are available to the surety unless he knew of their existence. As a New York opinion observes:

"The distinction which has been pointed out, viz., that inability on the part of the principal to contract is no defense to the guarantor, while fraud in the contract is, may be found in the civil law. This says that personal defenses do not pass to others, but that defenses, *inherent in the thing*, such as, among others, fraud and duress, are available to sureties." ¹²⁰

Do the same rules govern the guarantor's right to be relieved from his contract? The authorities generally agree that if the guarantor is an *absolute* one he is bound irrespective of the defense of the principal, one opinion, in which concurred all the court, saying:

"The contract thus made by the guarantors of the note was a promise as to its legality, and a liability which was

¹¹⁶ BRANDT ON SURETYSHIP AND GUARANTY, Sec. 171, 3d Ed. (1905).

¹¹⁷ Fuller v. Davis, 1 Gray (Mass.) 612 (1854); STEARNS ON SURETYSHIP, Sec. 104, 3d Ed. (1922).

¹¹⁸ Griffith v. Sitgreaves, 90 Pa. 161 (1879); STEARNS ON SURETYSHIP, Sec. 14, 3d Ed. (1922).

Contra, Robinson v. Gould, 65 Mass. 55 (1853); Oak v. Dustin, 79 Me. 23, 7 Atl. 815 (1887).

¹¹⁹ Hazard *et al.* v. Griswold, 21 Fed. 178 (1884).

¹²⁰ Putnam v. Schuyler, 4 Hun. (N. Y.) 166 (1875).

not dependent on the prosecution of a suit against the maker of the note, nor dependent on the validity or legality of the note. If the liability of a guarantor of commercial paper were dependent on extraneous circumstances not appearing on or suggested by the face of the instrument, and such guaranty might be rendered invalid because of fraud, forgery, or other circumstances that might be set up as between the maker and the acceptor of the paper, it would practically destroy the value of commercial paper, and unsettle business transactions, to the great detriment of public interests. The guaranty is a contract by which the validity of the instrument is represented, and is binding on the guarantor to the full extent of such representation."¹²¹

Will the guarantor be held liable, if his guaranty is not absolute, where there is a defense inherent in the principal's contract? The guaranty being separate from the principal's contract, and a different consideration supporting it, suggests that the same reasoning would not be applicable as in the case of a surety. Whether the result is different, in spite of a different reasoning applicable, the courts have not clearly determined. Obiter can be quoted to the effect that the conditional guarantor remains bound. For instance, one court held that a guarantor of certain bonds, which were found to be void, was liable, though the principal debtor could not be held. The reasons suggested were that both the guarantor and obligee were innocent of any wrongful act, the guarantor's contract was separate and distinct from that of the principal, and was made to induce the obligee to purchase the bonds from the principal. But while this court spoke of guaranty in general, the language of that guaranty shows it was an absolute one.¹²² In another case, the principal's obligation was illegal in part and partially valid, and could not be separated, which made the entire contract of the principal void. The court held the guarantor's contract could not be enforced, saying:

¹²¹ *Holm v. Jamieson*, 173 Ill. 295, 50 N. E. 702, 704 (1898). See *Veazie v. Willis*, 6 Gray (Mass.) 90 (1856); *Jones et al. v. Thayer*, 12 Gray (Mass.) 443 (1859). Apparently *contra* is *Bennett v. Corey*, 72 Ia. 476, 34 N. W. 291 (1887).

¹²² *Nelson et al. v. Hinchman*, 118 Fed. 435, 55 C. C. A. 251 (1902).

"It is true this action is on the contract of guaranty, and not the note, but the law is quite well settled that when the principal obligation is void for illegality that that infirmity will extend to and vitiate the contract of guaranty, and will constitute a defense open to the guarantor in an action on the guaranty itself."¹²³

The court, however, fails to make it clear whether the facts before it constitute an absolute guaranty or not.

It is believed that determination between absolute and conditional guaranty is precedent to a determination of the guarantor's liability where the principal is not bound. The conditional guarantor does not intend that his liability shall exceed that of the principal debtor. His promise is to answer for the payment of a debt or the performance of a duty in case of the failure of another person who is in the first instance liable to pay or perform. Therefore, unless he absolutely guarantees, he should not be liable if originally the obligee could not recover from the principal. The principal of *strictissimi juris* is an additional reason for relieving the guarantor.¹²⁴

Earl C. Arnold.

George Washington University Law School,
Washington, D. C.

¹²³ *Tandy v. Elmore-Cooper Live Stock Commission Co.*, 113 Mo. App. 409, 87 S. W. 614 (1905). The same Court had said in a prior case that: "We have no doubt, however, on reason as well as authority, but that the guarantor may, by the terms of his contract, make himself liable for the principal debt, although it be invalid." *The Sedalia, Warsaw and Southern Ry. Co. v. Smith*, 27 Mo. App. 378 (1887).

The Tennessee court held the guarantor liable where the consideration of the principal's note was Confederate money, and therefore, the principal was not bound. It does not appear whether this was an absolute guaranty or not. *Laughmiller v. Syler*, 7 Cold. (Tenn.) 158 (1869).

¹²⁴ *Merchants' National Bank v. Citizens' State Bank*, 93 Ia. 650, 61 N. W. 1065 (1895). See *Jack v. Sinsheimer*, 125 Cal. 563, 58 Pac. 130 (1899); *United States Gypsum Co. v. Central Railway Equipment Co.*, 152 Ill. App. 467 (1910); *Henry v. Fry*, 78 Misc. 130, 137 N. Y. S. 894 (1912); *Howard v. Smith et al.*, 91 Tex. 8, 38 S. W. 15 (1896).

A conditional guarantor was liable where the principal's contract was rendered non-enforceable because the statute of limitations had become a bar. *Miles v. Linnell*, 97 Mass. 298 (1867).

See *Putnam v. Schuyler*, 4 Hun. (N. Y.) 166 (1875).